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EXCISE

DEPARTMENT OF STATE

Washington, D.C. 20520

AUG 20 1970

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TO : E - Mr. Trezise

FROM : AF - Joseph Palmer 2nd

SUBJECT: Oil - Libya

The attached memorandum outlines what I believe will be the coming moves in Tripoli on the oil front--essentially a reflection of long-standing Libyan goals aimed at national control of a precious natural resource.

I have found during my consultations here that Washington is concerned over these same issues--and more, as the oil supply situation affects our interests around the world. We are in one of those rare situations where policy makers at all levels in the Department appear to recognize a major problem--while there is still time to do something about it. Everyone I have talked to seems to agree that we must:

1. Work out imaginative and flexible ways by which basic oil interests can survive the drive by oil-producing countries to control their own natural resources. The sooner the Arabs really share in the business of producing, transporting and selling oil, the sooner we and the Europeans will be dealing with more mature and responsible regimes.

2. Convince the European Governments that in a very fundamental sense this is also their problem. They make the most money on a barrel of Arab oil, and they should share the cost of assuring their own crude supplies.

Either or both of the foregoing initiatives would use up large chunks of precious political capital. That the interests at stake are worth the effort--there is no question in mind. It is also clear that only the President can decide whether the effort is feasible. Before he can choose, though, the Department must lay out the issues involved, the costs and alternative tactics.

The purpose of this memorandum is to suggest the Department undertake a full-scale review of the developing situation in the oil-producing countries; the political, economic and

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strategic trade offs inherent in the situation; USG goals as they pertain to foreign oil and what we could do to achieve them.

I think such a strategy paper should be begun immediately and be completed within a month--at the outside. Then it should move to the President.

At some point, we will have to face up to what--if anything--we should do with the companies. This will not be easy to face up to but I am convinced we will have to do so. In many ways I am reminded everyday of the Iranian crisis in which I was deeply involved. [redacted] BS This problem is a little further down the road; the first requirement is that the USG get its thinking in order.

In the meantime, I will return to Tripoli and do all that I can to convince the Libyans and the American companies to keep the oil flowing.

Attachment:

Memorandum on Libyan Oil

AF/N:LWalker:jk
8/20/70

OIL

LIBYAN GOALS

When Houari Boumedienne says: "...The resources of our nation must, firstly and above all, serve to promote our economy;" and when Muammar Qadhafi tells his people to prepare for "the battle for economic freedom" — they are both saying the same thing.

[redacted] B1

2. [redacted] B1

3. [redacted] B1

[redacted] B1

[redacted] B1

4. [redacted] B1

[redacted] B1

Implications for U.S. Oil Interests in Libya

[redacted] B1

[redacted] B1

The pursuit of minimum goals outlined above, however, will cause plenty of problems for US commercial interests:

- one or more of the oil companies will probably be nationalized.

- unlike the Algerian case where posted price negotiations are with the French government and are understood to be part of a larger set of issues, the Libyan price negotiations are being treated as an independent question. And the companies have only one pocket - profits - from which to buy a settlement.

- If the Libyans take too much in posted price -- and pursue their other minimum goals too fervently -- some American companies will walk off.

- And no matter how successful the Libyans are in pursuing their goals, the oil industry in Libya will henceforth be a even more difficult business for Americans than it is today.

But the fact to remember is that no matter how difficult business becomes, American companies will stay as long as there is an adequate profit to be made. We think the Libyans intend to permit -- within the limits imposed by their minimum objectives - continued access by American companies to Libyan oil on competitive terms. Each side, of course, could miscalculate the flexibility of the other -- and in this connection the outcome of the LARG's current attempts to joint-venture with the service companies may be more indicative of the future than the posted price negotiations -- but we think most of the U.S. companies here today will be here a year from now, in one form or another.

The Larger Arena

The pursuit of even minimum Libyan objectives has the following major repercussions outside Libya:

- The production cutbacks have raised tanker rates which in addition to the impending posted price hikes will increase energy costs in Western Europe and Japan; a higher posting here will bring pressures on postings in the Gulf and further eat into American profits there.

- The current crisis raises again the question of long-run availability of crude supplies; in addition -

- Possible Soviet and East European influence over Libyan oil -- whether through simple training and technical assistance arrangements or through barter deals -- keeps us all worried.

- And finally, the plight of the consuming countries may lead to attempts by our West European allies to replace the American middleman.

[redacted]

Recommendation

- Our minimum goals are to (1) help assure secure crude supplies to W. Europe and Japan, (2) minimize Soviet and East European influence and (3) keep American companies in the middle -- and in the Middle East.

Thus far, American companies and the Western governments most directly concerned have been on the defensive.

[redacted]

if we are truly concerned about our own minimum goals, we should:

[redacted]

the Algerian example is most instructive.

As Boumedienne said on July 17: "Certain groups have not been able to grasp the fact that Algeria is today an independent country. They persist in thinking that in oil matters it can be a question not of full and complete Algerian sovereignty, but of a sort of co-sovereignty. We say no. ...In a word, we re-affirm our wish to cooperate in all fields with all who wish to do so, providing they respect our country's policy."

[redacted]

Non-Company ways of looking at

OIL REVENUES

I. LARG view vis-a-vis companies

Formula for calculating LARG per-barrel oil revenue: 50% of remainder after royalties and operating costs are deducted from posted price.

Royalties	$ .27	
Operating Cost	$ .48	?
Subtotal	$ .75	
Minus Posted Price	2.21	
Times 50%	$1.46	= $ .73 = Tax
	plus	.27 = Royalty
		$1.00 = Total LARG per barrel revenues

(Note, that in effect, LARG pays 50% of $.48 operating cost — i.e. LARG loses $.24 in revenue and companies in effect pay only $.24 worth).

II - OPEC VIEW OF SHARES IN FINAL PER BARREL REVENUE AS REPRESENTED BY PRICE TO EUROPEAN CONSUMER

Production Costs	2.7%
Production Countries' Revenue	7.9%
Refinery Cost	3.3%
Distribution Costs	26.0%
Company Profits	6.3%
Consuming Country Revenue	47.5%
Transportation Costs	6.3%